

# *Memorandum*

---

**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Les White

**SUBJECT: 2006-2007 MID-YEAR  
BUDGET REVIEW REPORT**

**DATE:** January 30, 2007

---

## **RECOMMENDATIONS**

1. Approval of the 2006-2007 Mid-Year Budget Review Report.
2. Adoption of related Appropriation Ordinance and Funding Sources Resolution amendments in various funds as detailed in Section III (Appropriation/Clean-Up Adjustment Actions) in the 2006-2007 Mid-Year Budget Review.
3. Approval of the 3.0 position additions recommended in this report for the City Attorney's Office and the Office of Emergency Services also described in Section III of the 2006-2007 Mid-Year Budget Review.

## **OUTCOME**

The Mid-Year Budget Review document is designed to provide an understanding of the City's financial condition during the first six months of 2006-2007. Approval of the budget actions included in the Mid-Year Budget Review will address current year funding needs, fund various grant-supported activities, and process technical adjustments and corrections.

## **EXECUTIVE SUMMARY**

Through December, the City's overall finances remain sound, with revenues generally tracking at or above estimated levels and expenditures remaining within budgeted levels. In the General Fund, revenues are currently projected to exceed the budgeted estimates while expenditures are expected to remain within budget. If current revenue trends continue, the General Fund would have sufficient funding to support the recommended Mid-Year Budget actions and have additional revenue over the budgeted estimates by year-end. This higher collection level was factored into the development of the Preliminary General Fund Forecast that was issued in November 2006 and will be updated as part of the development of the final 2008-2012 General Fund Forecast that will be released at the end of February 2007 and the 2007-2008 Proposed Operating Budget that will be released in May.

As has been the practice in recent years, budget adjustments are recommended in the General Fund and approximately 40 special and capital funds, to provide a variety of technical

adjustments based on updated information and, in a limited number of instances, to address primarily one-time funding issues in the current year. Across all funds, the number of new projects for City Council consideration has been restricted to only those very few items that are critical, have their own funding source, or provide a unique opportunity at this point in time. In general, new and ongoing funding requests are brought forward during the annual budget process to ensure that these items are being considered with all other City Council priorities and potential funding needs.

In the General Fund, proposed adjustments totaling \$19.3 million are recommended in this report. These actions would be funded through increases to current revenues, new grant or reimbursement revenues, expenditure reductions, and the use of reserves. Of this amount, approximately 45% (\$8.6 million) is related to various grants and reimbursements. As has been the practice for the last five years, this report also includes an increase of \$4.2 million to the 2007-2008 Future Deficit Reserve by allocating departmental savings generated by the implementation of current year Cost/Position Management Plans. An additional \$3.6 million is recommended to support required adjustments, such as City Council District 4 and 6 special elections (\$1.2 million), and increased Jail Booking Fees (\$888,000). Other adjustments include the partial use of the Enhanced Parks Maintenance Reserve (\$1.8 million) to address critical one-time deferred parks maintenance needs and Development Fee Program additions that primarily focus on improving customer service (\$501,000). In addition, there are a small number of City Manager Initiatives totaling \$616,000 for items such as the Human Resources Peoplesoft Hiring Module (\$378,000) and recruitment funding for the Budget Office and Retirement Department Directors (\$76,000).

## **BACKGROUND**

The annual adopted budget is a financial plan predicated on the best information available at the time it is prepared. As with any budget, however, changing conditions may create the need to modify the original plan. Through its budget policies, the City Council has, therefore, designated mid-year as the appropriate time to perform a comprehensive review of the current year's budget, and the Mid-Year Budget Review as the appropriate vehicle for consideration of any revisions to the budget. In compliance with that process and the adopted budget schedule, this document is hereby presented to Council. It contains a comprehensive review of the status of the City's 2006-2007 Capital and Operating budgets. This review, although concentrating heavily on the status of the General Fund, also identifies all other City funds with expenditure and/or revenue variances considered significant enough to disclose, based on financial data through December 2006. City Council review of this report is currently agendaized for the February 13, 2007 Council meeting.

The Mid-Year Review document includes the following sections:

- **Transmittal Memorandum** - An overall summary of the contents of the Mid-Year Budget Review Report.

- **Section I: Operating Budget Status Report** - A review of the General Fund revenues and expenditures through Mid-Year and a review of selected special funds that have revenue and/or expenditure variances from the modified budget or other issues of interest.
- **Section II: Capital Budget Programs Status Report** - A review of the financial status of each Capital Budget Program.
- **Section III: Budget Augmentations/Reductions and Clean-up Adjustments** – A summary of the proposed budget augmentations/reductions in the General Fund and special/capital funds. A summary of clean-up adjustments in a number of funds is also included to provide technical appropriation and revenue estimate adjustments.
- **Section IV: Council Referrals and Information Memorandums** – The following three memorandums are included in this document:
  - San Jose Prepared! Community Outreach Progress Report: Two Additional Positions for Office of Emergency Services
  - Parks Capital Maintenance Spending Plan
  - Greenprint Standards
- **Section V: Appendices** - Financial results, prepared by the Finance Department, for all budgeted fund groups for the first six months of the year.

## **ANALYSIS**

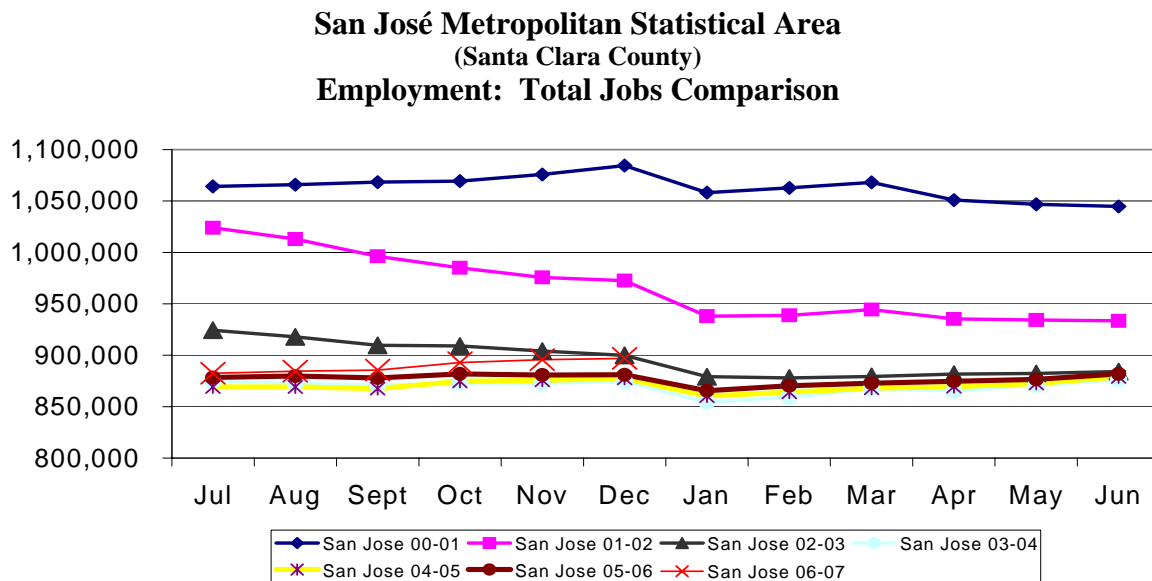
The Analysis section includes the following: an overview of the current economic environment; a discussion of General Fund performance through December; a summary of proposed General Fund budget revisions included in the Mid-Year Budget Review document; the status of selected special funds; and an overview of capital budget programs.

### **THE CITY AND THE ECONOMIC ENVIRONMENT**

When the 2006-2007 Adopted Budget was prepared, it was assumed that the improved level of revenue growth that had been experienced in 2005-2006 would continue for the economically sensitive revenue categories. Revenue growth was also assumed to remain at these moderate levels for the immediate future. The actual collections for the City confirm these basic assumptions.

Economic performance in the region remains positive. Employment levels in the area, while far below the peak in the early part of the decade, have started to show some small improvement. As shown in the chart below, the total employment figure of 896,900 jobs in December 2006 was approximately 2% above the 881,100 jobs in December 2005 and the 877,400 jobs in December 2004. Between November and December, employment grew by 1,200 jobs. As reported in the San José Mercury News on January 20, 2007, the growth of 15,800 jobs between December 2005 and December 2006 is the largest year-over-year growth since April 2001. Stephen Levy, director of the Palo Alto-based Center for Continuing Study of the California

Economy, is also quoted in this San José Mercury News article as stating “It looks like we can finally say the jobs recovery is really here.”. “It’s no longer just a possibility. It seems real now.”



In addition to the modest gains in the number of jobs, the unemployment rate remains low. The December unemployment rate for the San José area (unadjusted) was 4.2%, down slightly from 4.5% in November 2006 and below the December 2005 level of 4.5%. The December results for the San José area were slightly below the unadjusted figures for the State (4.6%) and the nation (4.3%).

Top business executives have also expressed some optimism about the local economy. As reported in the San José Mercury News on December 8, 2006, the latest Bay Area Council survey shows that in Santa Clara County, “50 percent of executives representing 139 companies forecast an improving Bay Area economy for the next six months, while only 11 percent said it would worsen – meaning optimists outnumbered pessimists by more than four to one....Along similar lines, 40 percent of Santa Clara County executives said they expect to add employees in the next six months, while only 5 percent said they anticipate a decrease in the workforce.”

In addition, consumer confidence at both the local and national level has shown improvement. According to the California Consumer Confidence Survey conducted by the Survey and Policy Research Institute at San José State University, consumer confidence in Silicon Valley rose sharply in January with increases in assessment of current economic conditions and expectations for the future. In January, 43% of Silicon Valley consumers said their personal financial situation was better now than one year ago, up from 38% in September, while 15% said it was worse. In Silicon Valley, 60% of residents say that business conditions are better than they were one year ago, up from 51% in September 2006. Looking ahead, 59% of Silicon Valley consumers anticipate good financial times in the region in the next 12 months, up from 45% in September 2006; while just 13% anticipate bad times, a drop from 20% three months ago. On a

national level, consumer confidence increased in December after slight drops in both October and November. The Conference Board's Consumer Confidence Index increased from 105.3 in November to 109.0 in December (1985 = 100).

As reported in Monthly Financial Reports and the 2008-2012 Preliminary General Fund Forecast, there remains a concern that the cooling housing market may still be a major factor that could, however, create a drag on economic growth in the near future. The potential extent of this impact has been the subject of many forecasts. In its fourth quarterly report of 2006, UCLA Anderson Forecast economist Ryan Ratcliff writes that "slowing housing markets will create a significant slowdown in the California Economy, but will not create a recession without a secondary source of weakness." A significant slowdown in this area would almost certainly negatively impact Sales Tax collections with the downward spending in construction materials and the reduction of consumer spending, as the "wealth effect" associated with housing appreciation diminished. Any major impact on Secured Property Taxes resulting from the current slowdown, however, would be a delayed one, likely not realized fully until 2007-2008 and 2008-2009, since current year Secured Property Tax receipts are based on the value of property assessed as of January 1, 2006, with adjustments for roll corrections. Since real estate activity was still performing well through calendar year 2005, current year Secured Property Tax receipts are expected to end the year with strong growth. SB 813 Property Tax collections and Construction and Conveyance Tax revenues, however, have and are expected to continue to drop significantly as the number of property transfers declines.

## **GENERAL FUND PERFORMANCE**

Through December, General Fund revenues and transfers totaled \$296.4 million, or 38.6% of budgeted estimates. This amount was \$26.0 million (9.6%) above the amount received last year at this time. A portion of this growth, however, is the result of timing differences between collections in the two years. Revenue collections are, however, currently tracking above expectations and should exceed the 2006-2007 budget estimates by year-end. This stronger performance reflects both higher than estimated collections in 2005-2006 and continued strength through 2006-2007 in many of the City's major revenue categories. The higher collections are spread among the majority of revenue categories rather than concentrated in one or two areas.

With stronger overall revenue performance and the availability of additional grants or reimbursement proceeds, upward revenue adjustments of \$12.3 million are recommended in this document. Of this amount, \$3.7 million of the higher current year collections would be used to fund expenditure needs and the remaining \$8.6 million of new grant and reimbursement revenue would be used to fund associated activities. As was projected in the November Forecast and recent Monthly Financial Reports, it is anticipated that additional revenue over the budgeted estimates will be available by year-end if current collection trends continue. This higher collection level was taken into consideration in the development of the 2008-2012 Preliminary General Fund Forecast that was issued in November 2006. This Forecast, which still resulted in a projected General Fund shortfall of \$19.8 million in 2007-2008, assumed that \$25 million would be available at the end of 2006-2007 from a combination of excess revenues and

expenditure savings for use in 2007-2008. Collection data to date is still generally consistent with those projections.

Through December, General Fund expenditures totaled \$354.8 million. This represents an increase of \$37.6 million, or 11.9%, from the December 2005 level of \$317.1 million. Encumbrances totaling \$39.3 million were also \$3.7 million (10.3%) above the December 2005 level of \$35.6 million. Expenditures and encumbrances through December constituted 45.0% of the total 2006-2007 modified budget (excluding reserves) of \$874.9 million. This was consistent with the 45.3% experienced in last year's budget at this time. Overall, expenditures are tracking as anticipated and are expected to end the year within budget. As part of this report, it is recommended that the departmental appropriations be reduced by \$4.2 million as part of the 2006-2007 Cost/Position Management Plan implementation and placed in the 2007-2008 Future Deficit Reserve for use in 2007-2008 budget balancing strategy options. With this reduction, it is anticipated that departments will expend nearly all of personal services and non-personal/equipment allocations by year-end.

Section I of this document provides a detailed discussion of the General Fund revenue and expenditure performance through December.

## **PROPOSED GENERAL FUND AUGMENTATION/REDUCTION RECOMMENDATIONS**

A total of \$19.3 million in expenditure adjustments are recommended in this Mid-Year Budget Review. These adjustments are offset by increases in revenue estimates, recognizing new revenues for grants and reimbursements, reducing expenditures associated with Departmental Cost/Position Management Plans, and the use of reserves. The following chart summarizes these recommended adjustments.

### **Proposed General Fund Augmentation/Reduction Recommendations**

#### **Proposed Adjustments**

- Grants/Reimbursements	\$ 8,583,501
- 2007-2008 Future Deficit Reserve	4,192,882
- Required Adjustments	3,617,641
- Enhanced Parks Maintenance	1,800,000
- City Manager Initiatives	616,000
- Development Services Program	501,190

<b>Total Proposed Adjustments</b>	<b>\$ 19,311,214</b>
-----------------------------------	----------------------

#### **Proposed Offsetting Solutions**

- Additional Grant/Reimbursement Revenue	\$ (8,583,501)
- Departmental Cost/Position Management Plan Savings	(4,192,882)
- Additional Revenue	(3,678,361)
- Earmarked Reserves	(2,856,470)

<b>Total Proposed Offsetting Solutions</b>	<b>\$ (19,311,214)</b>
--	------------------------

The recommended revenue and expenditure adjustments would result in a net increase of \$12.3 million from additional grant and reimbursement revenue (\$8.6 million) and increases in current revenue estimates (\$3.7 million). The additional revenue from grants and reimbursements includes \$3.75 million of funding from Comcast as part of the franchise agreement and a litigation settlement; an increase of \$1.6 million to the Transfers and Reimbursement category to reflect the increase in the Airport reimbursement for Police overtime associated with the "Orange Alert" level at the Airport; and an increase of \$1.1 million for the 2006 Super Urban Area Security Initiative (UASI) grant. Increases to the current year revenue estimates are spread among several categories, including Transfer and Reimbursements, Other Revenue and Use of Money and Property. The performance and adjustments in each of these categories are discussed in Section I of this document.

The remaining additions are proposed to be funded through the use of reserves or reductions in expenditures. All or portions of several earmarked reserves would be used to fund additions, including the Computer Reserve, the Equipment Reserve, the Salaries and Benefits Reserve, the Enhanced Parks Maintenance Reserve, and the Office of the Mayor Reserve. In addition, expenditure savings of \$4.2 million generated from the various departmental Cost/Position Management Plans would be allocated to the 2007-2008 Future Deficit Reserve.

Following is a brief description of the General Fund adjustments recommended in this report. Additional information on these adjustments is provided in Section III of this document.

### **Summary of Proposed Adjustments in the General Fund**

<b>GRANTS/REIMBURSEMENTS</b> (items supported by various grants or reimbursements)
--

<b><i>Public, Educational and Government Access (PEG) Operations</i></b> – Recognizes and appropriates funding that was received as part of the new franchise agreement with Comcast and as settlement of outstanding litigation and will be used to support PEG capital and programming costs in San José.	\$3,750,000
<b><i>Public Safety Activities</i></b> – Recognizes and appropriates grants and reimbursements that will be received for Police overtime at the Airport in response to Level Orange security reimbursed by Airport funds (\$1,602,911), Police Mandated Driver Training (\$184,260), Office of Traffic Safety Checkpoints (\$54,933), and a net increase for various public safety grants (\$47,359).	\$1,889,463
<b><i>Homeland Security Activities</i></b> – Allocates grants received for the 2006 Super UASI Program (\$1,000,000 for the Office of Emergency Services and \$148,873 for the Police Department), and State Homeland Security Grant for Special Operations (\$154,402).	\$1,303,275
<b><i>Neighborhood Services Activities</i></b> – Recognizes and appropriates grants and reimbursements for the San Jose After School Program (\$614,313), Adult Day Care (\$44,301), Animal Care and Services (\$463,000), Senior Nutrition (\$72,276), Adults Literacy and Families for Literacy programs (\$59,714), Landfill Enforcement (\$28,484), and Senior Companion Program (\$10,818).	\$1,292,906

### Summary of Proposed Adjustments in the General Fund (Cont'd.)

<b><i>Community and Economic Development Activities</i></b> – Recognizes and appropriates grants and reimbursements for Miscellaneous Public Art activities (\$125,459), Sports Opportunity Fund (\$7,398), and increased reimbursement from Airport funds for debt service payments for the FMC site (\$140,000).	\$272,857
<b><i>General Counsel Services</i></b> – Converts a Redevelopment Agency direct-charged position to civil service in the City Attorney's Office to align all administrative support positions. This position, which will be reimbursed by the Redevelopment Agency, will continue to support General Counsel activities.	\$75,000
<b>Total Grants and Reimbursements</b>	<b>\$8,583,501</b>

<b>2007-2008 FUTURE DEFICIT RESERVE</b> (funding reserved for the 2007-2008 budget balancing strategy)
--

<b><i>2007-2008 Future Deficit Reserve</i></b> – Increases the 2007-2008 Future Deficit Reserve by \$4.2 million to reflect the cumulative savings identified in the various departmental Cost/Position Management Plans as more fully discussed by City Service Area in Section III of this report. This would bring the Reserve to \$10.6 million.	<b>\$4,192,882</b>
--	--------------------

<b>REQUIRED ADJUSTMENTS</b> (items considered unavoidable and/or prudent to fund)
---

<b><i>Council District Special Elections</i></b> – Adds funding for a special election in March 2007 to elect City Council members in Districts 4 and 6 and for a potential run-off election in Council District 4 in June 2007. <i>Funding Source:</i> Increase in current year revenues	\$1,161,000
<b><i>Jail Booking Fees</i></b> – Adds funding to cover the City's cost to process its prisoners based on a recalculation by the County that significantly increased the cost to San José. <i>Funding Source:</i> Increase in current year revenues	\$888,000
<b><i>Economic Uncertainty Reserve</i></b> – Recognizes proceeds from the sale of surplus property and allocates those funds to the Economic Uncertainty Reserve per City Council policy. <i>Funding Source:</i> Proceeds from the sale of surplus property	\$393,000
<b><i>Hayes Mansion</i></b> – Adds funding to cover the increase in the variable rate debt service payment for the Hayes Mansion Conference Center. <i>Funding Source:</i> Increase in current year revenues	\$230,000
<b><i>Old City Hall Land Use Planning</i></b> – Adds funding for continued exploration of future uses for the Old City Hall and employee parking lot. <i>Funding Source:</i> Increase in current year revenues	\$175,000
<b><i>Body Armor and Ammunition Cost Increases</i></b> – Adds funding to the Police Department to cover cost increases for body armor and ammunition due to military demand. <i>Funding Sources:</i> Equipment Reserve (\$100,000) and increase in current year revenues	\$162,450



**Summary of Proposed Adjustments in the General Fund (Cont'd.)**

<b><i>Public Art in Private Development</i></b> – Provides funding to correct a budget error related to public art funds that were received from private developers in prior years. <i>Funding Source:</i> Increase in current year revenues	\$136,482
<b><i>Public Works Counter Services</i></b> – Provides funding to support general public counter inquiries and flood management services that were inadvertently omitted from the budget. <i>Funding Source:</i> Increase in current year revenues	\$101,000
<b><i>Customer Call Center Work Space Reconfiguration</i></b> – Provides funding to increase the size of cubicles and relocate staff to be co-located on one floor at the Call Center. The current cubicle size and extreme proximity of co-workers creates noise levels that are less than ideal for call taking. <i>Funding Source:</i> Increase in current year revenues	\$100,000
<b><i>IAFF Arbitration</i></b> – Adds funding for legal services to assist in the interest arbitration between the International Association of Firefighters and the City. <i>Funding Source:</i> Salaries and Benefits Reserve	\$100,000
<b><i>GASB 43 and 45 Actuarial Services</i></b> – Provides funding for actuarial services to assist in the determination of the impact of GASB 43 and 45 (post-employment retirement benefits) upon the City. <i>Funding Source:</i> Salaries and Benefits Reserve	\$50,000
<b><i>Elections Commission Audit</i></b> – At the request of the Mayor's Office, adds funding that would allow the Elections Commission to begin addressing Reed Reform #19 (Plug loopholes in the campaign financing ordinance that make it possible to contribute unlimited amounts of money in the form of paid campaign workers). The Election Commission has been forwarded the tasks of 1) reviewing as part of an audit and reporting on activities of campaign committees during the 2006 elections; and 2) making recommendations for changes in language or enforcement of the City ordinance. <i>Funding Source:</i> Increase in current year revenues	\$20,000
<b><i>Miscellaneous Adjustments</i></b> – Adds funding for the non-reimbursed portion of the Senior Nutrition Program increases (\$38,459), expanded Field Training Program (\$25,000) and software maintenance costs for Telestaff (\$14,850) in the Police Department, and Workers' Compensation State License Cost increase (\$22,400). <i>Funding Sources:</i> Salaries and Benefits Reserve (\$25,000) and increase in current year revenues	\$100,709
<b>Total Required Adjustments</b>	<b>\$3,617,641</b>

<b>ENHANCED PARKS MAINTENANCE</b> (one-time parks maintenance needs funded from the Enhanced Parks Maintenance Reserve)
---

<b><i>Enhanced Parks Maintenance</i></b> – Provides funding to address critical deferred park maintenance activities by purchasing new mowers, sensors to form a central irrigation network, and to complete all outstanding audit recommendations related to the San Jose Family Camp site. These actions will not increase operating and maintenance costs.	<b>\$1,800,000</b>
---	--------------------

### Summary of Proposed Adjustments in the General Fund (Cont'd.)

<b>CITY MANAGER INITIATIVES</b> (items that are discretionary in nature, but are considered urgent for the effective delivery of City services)
---

<p><b><i>Human Resources Peoplesoft Hiring Module</i></b> – Provides funding to implement a new recruiting module in Peoplesoft and replace the current QuickHire system by using consultant services and temporary staff. The system will provide significant process improvements for applicants and hiring managers. It will also streamline and automate Quikhire’s manual, paper-intensive process.  <i>Funding Sources:</i> Computer Reserve (\$185,150) and increase in current year revenues</p>	\$378,000
<p><b><i>Executive Recruitments</i></b> – Provides funding for the recruitment of replacements for the Retirement Department and Budget Office Directors.  <i>Funding Source:</i> Salaries and Benefits Reserve</p>	\$76,000
<p><b><i>Revenue Management</i></b> – Provides one-time funding for temporary staff in the Finance Department that will focus on increasing Sales Tax and Business Tax collections. It is anticipated that these positions will more than offset their costs and will begin implementation of a Revenue Collection Strategic Plan that is anticipated to be brought forward as part of the 2007-2008 Proposed Budget process.  <i>Funding Source:</i> Increase in Sales Tax revenue estimate</p>	\$66,000
<p><b><i>City-Wide Technical Communications Strategy</i></b> – Provides funding for contractual technical assistance to participate in the Wireless Silicon Valley project. This project will assist the City in its development of a comprehensive WiFi strategy that would later be included in a city-wide communications strategy.  <i>Funding Source:</i> Computer Reserve</p>	\$50,000
<p><b><i>Okayama Sister City</i></b> – Provides funding for the Okayama Sister City 50<sup>th</sup> Anniversary Celebration that will be held April 27-30, 2007, including the welcome reception, a youth symphony concert, a luncheon and dinner, banners, gifts, and translation services.  <i>Funding Source:</i> Increase in current year revenues</p>	\$26,000
<p><b><i>Management Services</i></b> – Provides funding to assist the Planning, Building and Code Enforcement Department with strategic planning efforts.  <i>Funding Source:</i> Increase in current year revenues</p>	20,000
<p><b>Total City Manager Initiatives</b></p>	\$616,000

<b>DEVELOPMENT FEE PROGRAMS</b> (items that support and are funded by the Building, Fire, Planning, and Public Works Development Fee Programs)
--

<p><b><i>Customer Service Improvements</i></b> - Various adjustments that include the purchase of a Request for Service module for the integrated development program billing system, a survey tool to benchmark to other jurisdictions, third party plan check services, personal services to address plan review cycle time performance issues, and staff training and code books to ensure compliance with the recently updated building and fire codes.</p>	501,190
---	---------

<b>Total Mid-Year Recommended Adjustments</b>	<b>19,311,214</b>
---	-------------------

## **STATUS OF SELECTED SPECIAL FUNDS**

### Airport Operating Funds

The Airport Maintenance and Operation Fund is the primary operating fund that supports Airport operations, including Airport staff, Airport police services, Fire Station 20 aircraft rescue and fire fighting, interdepartmental charges, and overhead to the General Fund. Consistent with last year, revenues through December are running slightly above budgeted levels. On the expenditure side, both personal services and non-personal/equipment expenditures are tracking below estimated levels. The Airport has put into place a structured budget savings strategy for 2006-2007 that is expected to generate approximately \$2.5 million in expenditure savings by year-end.

Although revenues are performing approximately as budgeted due to conservative estimates, activity at the Airport continues to be sluggish. Passenger traffic, landings, takeoffs, cargo weights, and rental car activity are all below last year's levels.

### Convention and Cultural Affairs Fund

On an overall basis, revenues in the Convention and Cultural Affairs Fund are performing as anticipated. Expenditures through December in the Convention and Cultural Affairs Fund are tracking slightly below expectations in personal services due to position vacancies. Non-personal/equipment expenditures are slightly above anticipated levels due to the use of contract labor to cover its vacancies; however, many of these vacancies have since been filled so the use of contract labor should be reduced in the second half of the year. A transfer of personal services savings to the Non-personal/Equipment appropriation in the amount of \$350,000 is recommended in this report to properly align the contract labor costs with the budget.

### Integrated Waste Management Fund

Overall, revenues and expenditure are tracking as anticipated through December. The Material Characterization Study approved in the 2006-2007 Adopted Budget to determine the sources and composition of material collected in the Recycle Plus program has been deferred until spring 2008. The \$300,000 allocated for the study is recommended to be reallocated to the Call Center to cover the additional costs being incurred for additional temporary staffing to address the much higher than anticipated call volume and wait time experienced due to the transition to the new utility billing system and in anticipation of the transition to the new hauler.

### Transient Occupancy Tax Fund

Revenues in the Transient Occupancy Tax Fund are tracking above budgeted levels. Overall, occupancy rates for the first six months of the fiscal year averaged 57.4%, which is above last year's level of 52.7%. Room rates have increased slightly from last year's average of \$112 to \$125. Overall, hotel activity is above (120%) the same period last year. If this trend continues, revenue could end the year approximately 10-15% above budget. Expenditures through December in the Transient Occupancy Tax Fund are tracking as anticipated.

## **STATUS OF CAPITAL BUDGET PROGRAMS**

The 2006-2007 Adopted Capital Budget totaled \$1.38 billion. Through the first six months of the year, the City Council approved budget adjustments that increased the capital budget by \$225.4 million to a total of \$1.61 billion. Most of this change (\$217.1 million) reflects technical adjustments that were processed as part of the 2005-2006 Annual Report, including a net upward adjustment of \$140.0 million to the beginning fund balance figures and rebudgets of \$33.7 million to carryover funds to 2006-2007 to complete projects. The remainder of approved adjustments to the budget through the first six months of the fiscal year included a small number of new projects or projects with changes in cost and/or scope, as well as technical adjustments to funding sources.

During the first half of the year, project expenditures were generally tracking within budget. With the trend of rising costs in construction costs as experienced by several awards to date, it is anticipated that projects awarded through the remainder of the year could experience shortfalls that may require budget adjustments or changes in project scopes. These trends will be carefully monitored and corrective actions reported to the City Council through the quarterly CIP project monitoring process. A separate discussion of the impact of cost escalation on the City's bond programs is being presented to the City Council separate from this document on January 30, 2007.

### Capital Budget Revenues

Section II of this report contains a detailed update on the financial status of each Capital Program, including a discussion of the major revenue sources. As has been reported in Monthly Financial Reports, the major economically sensitive revenue sources that support the Capital Program are expected to end the year within adopted estimates. In addition, it is anticipated that the major non-economically sensitive revenues such as transfers and contributions from other agencies that support many of the capital programs will perform as projected.

The Building and Structure Construction Taxes and the Construction Excise Taxes that support the Traffic Capital Program are currently expected to meet or exceed budgeted estimates by year-end. Through December, Building and Structure Construction Taxes totaled \$5.7 million, which represents an increase of 20.7% through the first six months of last year and 59% of the current budgeted estimate of \$9.69 million. Construction Excise Tax collections through December totaled \$7.8 million, up 17.4% from last year and 57% of the budgeted estimate.

As discussed in recent Monthly Financial Reports, Construction and Conveyance Tax (C&C) revenues that support many of the capital programs continue to decline, reflecting the reduced level of real estate transactions city-wide. As a significant decline had been anticipated when the budget was developed, these revenues are still expected to meet or exceed the budgeted estimate by year-end. The 2006-2007 budget estimate of \$27 million allows for a decline of 45% compared to 2005-2006 actual performance. Through December, C&C taxes totaling \$17.6 million have been received, which represents a decline of 24% from last year. Since nearly 98% of the C&C taxes are comprised of conveyance receipts, property transfers are the main driver in

this revenue category. While the real estate market has been extremely strong over the last several years, December represented the eighth consecutive month of declining revenues compared to the same month in the prior year. A number of factors suggest these revenues may not have yet reached bottom. The number of property transfers for all types of residences in the first half of 2006-2007 declined by 26% and the number of days on the market for completed sales increased 49% compared to the first six months of 2005-2006. The median home price of \$695,000 is at its lowest point since January 2006. This figure represents less than a 1% growth since the December 2005 price of \$690,000. Given the current economic conditions in this region, we have been anticipating a fall off in the housing market that drives the C&C Tax collections for the last couple of years. Staff will continue to closely monitor activity and collection levels. Adjustments to the current year revenue estimates will be brought forward at the end of the fiscal year based on actual collections. For planning purposes, a 2006-2007 revenue estimate of \$34 million is being used in the development of the 2007-2008 Proposed Capital Budget.

#### Capital Program Adjustments

A series of recommended Appropriation Ordinance and Funding Sources Resolution amendments to the Adopted Capital Budget are included in Section III of this report. The most significant adjustments include the following:

- In the Airport Capital Program, the Consolidated Rental Car Facility (\$4.4 million), Public Parking Garage (\$2.3 million) and Terminal Area Improvements Phase I projects are being accelerated to ensure adequate resources to continue with design efforts. In addition, a limited number of augmentations are recommended, including the Federal Inspection Service 3<sup>rd</sup> Floor Lounge Build-Out (\$540,000), Part 139 Compliance Projects (\$350,000), Airport Parkway Trail Under-crossing (\$229,000), and Advanced Planning (\$200,000).
- Several actions are recommended in the Park and Community Facilities Capital Program to add a limited number of new projects and to address current year funding needs. The major changes include funding for the Reserve: Newhall Neighborhood Park (\$1.0 million from the Park Trust Fund); Bascom Community Center (\$227,000 from the City-wide C&C Tax Fund and \$747,450 from Park Trust Fund); Plaza De Cesar Chavez Water Fountain Renovation (\$650,000 from the City-wide C&C Tax Fund); Chelmers Park Development (\$200,000 from the District 8 C&C Tax Fund and \$233,000 from the Park Trust Fund); TRAIL Los Gatos Creek Reach IV (\$280,000 from the Park Bond Fund); Selma Olinder Dog Park (\$250,000 from the District 3 C&C Tax Fund); Alviso Park Master Plan (\$250,000 from the Park Trust Fund); LoBue Park Development (\$228,000 from the Park Trust Fund); Newhall Neighborhood Park (\$200,000 from the Park Trust Fund); TRAIL: Coyote Creek – Phalen Ave to Los Lagos Golf Course (\$200,000 from the Park Trust Fund); Alum Rock Park Waterline Relocation (\$200,000 from the City-wide C&C Tax Fund); Alum Rock Park Entrance Restroom (\$150,000 from the City-wide C&C Tax Fund); West San José Community Center Landscaping and Monument Design (\$150,000 from the District 1 C&C Tax Fund); and TRAIL: Los Gatos Creek Reach V (\$137,000 from the District 6 C&C Tax Fund) projects.

- In the Library Capital Program, additional funding is recommended in the Branch Library Bond Project Fund to fund Land Acquisition for the Bascom Branch Library and Community Center (\$1.0 million). Funding is also recommended for New Branch Opening Day Collections (\$151,000) in the Construction and Conveyance Tax Fund.
- In the Traffic Capital Program, the appropriation of project funding and associated revenue for the Bailey/Route 101 Improvements, Saratoga/Graves Street Improvements, and Seismic Bridget Retrofit – William Street projects are recommended to recognize grant, developer, and VTA contributions. A limited number of funding augmentations are recommended for the Senter Road: Tully to Singleton (\$1.0 million), Branham Lane Improvements (\$200,000), Oakland Road: Route 101 to Montague (\$158,000), and Story Road: Senter to McLaughlin (\$124,000) projects.
- In the Public Safety Capital Program, additional funding from the Fire C&C Ending Fund Balance is recommended to fund Fire Radio Infrastructure (\$100,000), and replacement tools (\$50,000). In addition, funding of \$290,000 received from developers is recommended for appropriation for Fire Station #33 (Communications Hill).
- In the Communications Capital Program, additional funding is recommended for the Fire Radio Infrastructure (\$460,000) project.

## **LOOKING FORWARD**

Planning efforts are well underway on the development of the 2007-2008 Proposed Operating and Capital Budgets. The 2008-2012 General Fund Forecast serves as a starting point in the budget development process as it compares the projected revenues and expenditures for the upcoming five-year period. As reported to the City Council in November, the Preliminary 2008-2012 General Fund Forecast showed a General Fund deficit of \$19.8 million in 2007-2008. In late February, the Administration will bring forward an updated 2008-2012 General Fund Forecast that will take into consideration the actual performance through the first half of 2006-2007 and revised revenue and expenditure assumptions.

Although there have been many critical needs identified throughout the organization, such as the Watson Park Site Remediation Project, Sunshine Reform implementation, restoring and improving services to our community, police staffing, and deferred maintenance, infrastructure and technology items, these needs will be fully analyzed and considered, as appropriate, during the upcoming Proposed Budget process. We look forward to the City Council Priority Setting process, as well as the release, review, and approval of the Mayor's March Budget Message that will serve as a guiding document for the Administration in its development of the 2007-2008 Proposed Budget.

## **PUBLIC OUTREACH/INTEREST**

- ✓ **Criteria 1:** Requires Council action on the use of public funds equal to \$1 million or greater.
- ☐ **Criteria 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City.
- ☐ **Criteria 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach.

This document is posted on the City's website for February 13, 2007 Council agenda. Additional outreach efforts have been conducted for certain projects, such as Watson Park, by various City departments.

## **CONCLUSION**

Through the mid-point of the year, the City's finances remain in sound condition, with revenues generally tracking at or above estimated levels and expenditures remaining within budgeted estimates. Overall fiscal performance was consistent with the economic assumptions used to develop the 2006-2007 Adopted Budget. It was assumed that the economy would continue its modest gains, with no major upward or downward shifts during the year. The steady improvement that has been experienced over the last year was expected to continue. The continuation of this favorable performance through the remainder of 2006-2007 was built into the 2008-2012 Preliminary General Fund Five-Year Forecast. This Forecast, however, still projected a General Fund shortfall of \$19.8 million for 2007-2008.

While the overall economic conditions remain favorable, the slowing housing market and the lack of significant job growth remain areas of concern. The stable, but low, job growth is still considered a barrier to any major growth in the local economy. A significant slowing in our housing market could also still have major direct impacts on a number of the City's revenue sources this year, including Property Taxes and Construction and Conveyance Taxes.

As always, the Administration will continue to closely monitor our current year financial status and report to the City Council any and all significant developments through the regular Monthly Financial Reports.

Les White  
City Manager

### **Certification of Funds**

I hereby certify that there will be available for appropriation in the designated funds and in the amounts as listed below in fiscal year 2006-2007 monies in excess of those heretofore appropriated therefrom:

General Fund	\$12,260,906
Airport Maintenance and Operations Fund	1,742,911
Airport Revenue Fund	
1,742,911	
Benefit Fund	862,000
Building and Structure Construction Tax Fund	479,000
Civic Center Parking Fund	24,464
Community Facilities Revenue Fund	230,000
Fire Const & Conveyance Tax Fund	290,000
Construction Excise Tax Fund	70,000
Gift Trust Fund	360,656
Integrated Waste Management Fund	6,557

Jennifer Maguire  
Acting Budget Director